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A look at business growth and contraction in Europe

Lunchtalk, Bruegel, December 13th, 2011

Guest speaker Alberto Bravo-Biosca, Senior Economist at NESTA, presented his study on the distribution of business growth in Europe as compared with the US. This study was conducted using a new database on business growth dynamics.

Reinhilde Veugelers, Senior Research Fellow of Bruegel, introduced Dr. Bravo-Biosca with a few words on his background and his work at NESTA. The current study examines firm-level data; Although Europe had been catching up to the United States since after the second World War, the trend started reversing in the mid-90s, much before the current crisis. Some key questions are: What explains the EU-US productivity gap? Where is Europe's Google or Starbucks? The Fortune 500 share of European firms founded after 1975 is only 2% as compared to 16% of American firms.

Most previous studies have focused on within-country growth. This study looks at cross-country growth through a new database describing the distribution of firm growth across 11 countries. The data were gathered from official business register data. These data contain business growth and contraction for surviving employer enterprises for up to 51 sectors, size breakdowns, and age breakdowns. Some caveats are: possible false entry/exits through longitudinal linkages, shifting boundaries of the firm, selection bias, and internal growth versus growth through acquisitions. Additionally, data for France and Germany were not available.

Dr. Bravo-Biosca began the session with some facts on start-ups and high-growth firms which might be counter to common perceptions. Firstly, although the SMEs employ the majority of employees, they don't grow fast. Secondly, there are high-growth firms in all sectors, not just in "growth sectors." Although young firms grow faster on average, most fast-growers are more than 5 years old. Very few startups, only around 2%, survive and grow. Additionally, for most firms it is very unusual to have high growth more than 2 periods in a row – so high growth may me more of a stage for firms than a type of firm. Lastly, a large proportion of jobs are created and destroyed by a minority of firms. It has also been shown that expansion and contraction are correlated.

The comparison between business growth reveals that Europe has a much larger share of 'static firms' while the US has a larger share of both growing and shrinking firms. This is true across sectors. When the comparison is broken down by country, similar results can be found for most countries. There may be growth without selection in countries, such as Spain, which has comparatively more high-growth firms and less shrinking firms. This appears not to be sustainable in the long-term, as these data were mostly from before the bubble burst. Now it would likely look much different.

When looking at the data per firm size, a most interesting result is that large European companies shrink much less than large US companies, possibly indicating greater competition in the US market. Incumbents may be more challenged in the US and entrepreneurs may play an important role. Additionally, the growth gap between medium companies in the EU is much smaller than the one in the US, Additionally, incumbent firms create jobs in the EU while they actually destroy jobs in the US. There has been some evidence linking dynamic growth distribution to productivity. More dynamic growth distributions signal experimentation and innovation. The results show that a 5% increase in the share of static firms is associated with a 1% lower

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annual TFP growth. A large share of growing / shrinking firms is associated with higher productivity growth. This effect is stronger as countries converge to the technology frontier. Similar results can be obtained using labor productivity. Lastly, when looking at the distribution of firm-level management practice scores by country, a lot of EU countries have a long tail of badly-managed companies which survive. While, the US has a very short tail and more well-managed companies surviving.

Dr. Bravo-Biosca then proceeded to suggest the possible policy implications of these results:

- As a minority of firms account for a disproportionate share of jobs, the quality of entrepreneurs may be more important than quantity.
- Having high growth "typically" means letting other firms shrink.
- Targeted interventions may distract from wider reforms.
- Provide access to finance through venture capital or intermediaries
- Possibly providing a single market for entrepreneurs so as to solve problems with fragmented business regulation. Creating a new separate and optional full-fledged 28th (or 18th) regime for new companies.

Chris Allen, of DG Enterprise, acted as the discussant. The EU should emphasize competition – why does bad management still exist? Additionally, some sectors in the EU have a stronger single market than other, with a bigger problem in the services sector. The big story is the need for reforms and make sure that all countries comply with the reforms.

The talk closed with a discussion which raised several points: country-specific regulation which could impede growth; SMEs may have limited incentive to grow if they are owned by persons who would rather have risk-free high margins than growth – debt may inspire growth at the cost of low profit, as in the case of Japanese firms in the early 90s.